

**Credit Opinion: Federal Home Loan Banks**

Global Credit Research - 25 Jul 2013

Reston, Virginia, United States

**Ratings**

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Aaa
ST Issuer Rating	P-1

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**Key Indicators**

**Federal Home Loan Banks (Consolidated Financials)[1]**

	[2]3-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total assets (USD million)	738,706.0	762,454.0	766,086.0	878,109.0	1,015,583.0	[3]-7.6
Tangible common equity (USD million)	49,521.0	50,904.0	52,062.0	56,304.0	59,114.0	[3]-4.3
Total shareholders' equity (USD million)	48,773.0	49,478.0	47,834.0	50,807.0	50,947.0	[3]-1.1
Return on average assets (FHLB) (%)	0.3	0.3	0.2	0.2	0.2	[4]0.2
Return on average equity (FHLB) (%)	5.4	6.5	3.8	4.8	4.0	[4]4.9
Advances / Total Assets (%)	55.2	54.2	52.6	52.8	60.6	[4]55.1
Mortgage Loans / Total Assets (%)	6.5	6.5	7.0	7.0	7.0	[4]6.8
Retained earnings and related reserves / Total Assets (%)	1.5	1.4	1.1	0.9	0.6	[4]1.1
Private Label RMBS / Total Assets (%)	3.3	3.3	3.8	4.2	4.6	[4]3.8
Total regulatory capital ratio (FHLB) (%)	6.7	6.7	6.9	6.5	5.9	[4]6.6
Liquid Assets (FHLB) / Short Term Debt (%)	55.1	54.0	57.2	58.0	43.3	[4]53.5

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] US GAAP [3] Compound Annual Growth Rate based on US GAAP reporting periods [4] US GAAP reporting periods have been used for average calculation

**Opinion**

**SUMMARY RATING RATIONALE**

On July 18, 2013, as a result of affirming the U.S. Government's Aaa debt rating with the outlook updated to stable from negative (See Moody's press release titled: "Moody's affirms Aaa ratings directly linked to US Government bond rating; outlook changed to stable"), Moody's affirmed the Aaa long-term deposit ratings of all of the FHLBanks as well as the Aaa long-term bond rating of the FHLBank System and updated the outlook to stable from negative. At the same time, Moody's affirmed the Prime-1 short-term deposit ratings of all of the FHLBanks and the Prime-1 short-term bond rating of the FHLBank System.

The Federal Home Loan Bank System's (FHLBank System or FHLBanks) Aaa with a stable outlook and Prime-1 long- and short-term bond ratings reflect the combination of the following elements: 1) an a1 baseline credit assessment (BCA), 2) very high support from the Aaa with a stable outlook rated US Government, and 3) high dependence between the FHLBanks and the US Government.

The FHLBank System's a1 BCA reflects FHLBank System's financial strength, earnings stability, excellent asset quality and special role as a provider of liquidity to US banks. In arriving at the FHLBank System's BCA, Moody's considers the individual BCA of each of the FHLBanks as well as the profile of the FHLBank System as if it were one, combined entity. The FHLBank System's BCA incorporates the joint and several liability of all FHLBank consolidated obligations.

The outlook on the FHLBanks is stable reflecting the stable outlook on the US government. Any rating actions on the US Government would likely result in all individual FHLBanks' long-term deposit ratings and the FHLBank System long-term bond rating moving in lock step with any US sovereign rating action.

## **Recent Developments**

### **GSE Reform**

GSE reform has not progressed very far and Moody's expects very limited progress before the end of 2013. To date, the reform is primarily focused on the roles of Fannie Mae and Freddie Mac. However, the FHLBanks are likely to be included in the reform, though the impact remains uncertain. Moody's will monitor GSE reform as it progresses, as well as its impact on the FHLBanks.

## **Rating Drivers**

Joint and several liability reduces default risk of Systemwide liabilities

Central liquidity provider to US banks

Excellent asset quality of 1) the advance portfolio, 2) the investment portfolio excluding the private-label RMBS portfolio, and 3) the mortgage portfolio

Narrow charter and bank consolidation constrain growth and profitability

Substantial borrower concentrations at individual FHLBanks

Material private-label securities portfolio

## **Rating Outlook**

Moody's stable outlook for the FHLBank System's long-term bond rating reflects the stable outlook of the US government's Aaa debt rating.

## **What Could Change the Rating - Up**

An upgrade of the FHLBank System's BCA is unlikely. However, an upgrade of the BCA could occur if the FHLBanks re-focused their businesses such that advances represent more than 70% of assets while maintaining i) strong profitability as reflected by an ROAA consistently in excess of 0.35%, ii) a stable member profile and iii) continued strong asset quality.

## **What Could Change the Rating - Down**

Any rating actions on the US Government would likely result in all individual FHLBanks' long-term deposit ratings and the FHLBank System's long-term bond rating moving in lock step with any US sovereign rating action.

Barring a downgrade of the US sovereign rating or a material downgrade of the FHLBank System's BCA, Moody's does not expect changes to the FHLBank System's long- and short-term bond ratings. This is due to the fact that the bond ratings incorporate an expectation of a very high degree of US Government support.

Factors that could lead to a downgrade of the FHLBank System's BCA of a1 include materially higher loss expectations on the private-label RMBS portfolio, materially lower profitability (quarterly net losses over four quarters), or significant asset-liability mismatches.

## **DETAILED RATING CONSIDERATIONS**

The FHLBanks' primary business is lending to member institutions in the form of advances, which are generally short-term and over-collateralized, minimizing the credit risk on these loans. The FHLBanks also purchase mortgage loans through either the Mortgage Partnership Finance® (MPF®) Program or the Mortgage Purchase Program (MPP). The FHLBanks also invest in securities, principally MBS, subject to an investment limit of three times regulatory capital without approval by the Federal Housing Finance Agency. Below are the detailed rating factors that influence the System's ratings and outlook.

### **Baseline Credit Assessment**

#### Profitability

FHLBank System's modest but consistent profitability (as measured by ROAA) reflects the primarily low risk profile of its asset base. Reported ROAA was 0.3% as of March 31, 2013 and December 31, 2012.

#### Capital Adequacy

FHLBanks are required by legislation to maintain a minimum regulatory capital level of 4.0% of its total assets. As of March 31, 2013, the FHLBanks' combined regulatory capital ratio was 6.7%. In Moody's view, capital levels reflect the low risk profile of the FHLBank System's asset base which is primarily comprised of advances to members.

#### Asset Quality and Credit Risk Management

Excluding the private-label RMBS portfolio, the asset quality of the FHLBank System has been exceptional. Advances represented approximately 55% of assets as of March 31, 2013. The FHLBank System has never incurred a credit loss on an advance in its 80 year history. The FHLBanks' collateral requirements on advances, and their priority lien status, support credit quality in the event a member defaults on its advances. Each FHLBank has sole credit approval power and establishes its own underwriting standards and eligible collateral within Federal Housing Finance Agency guidelines. Eligible collateral includes current first-lien residential mortgages (overwhelmingly single-family) or securities backed by such mortgages, Federal Agency securities, FHLBank deposits and other real estate-related assets approved by the relevant FHLBank's board of directors.

Holdings of non-MBS instruments consist of high-quality liquid investments such as commercial paper, federal funds, resale agreements, US Government guaranteed debt and US Treasury securities. Agency and government guaranteed debt purchased in the investment portfolios of the FHLBanks require at least the rating of the US Government, reflecting the System's conservative credit standards. Potential losses on each of the respective FHLBanks' private-label RMBS portfolio represent the most significant credit risk to the FHLBanks, in Moody's view.

The FHLBanks' conforming mortgage loan programs, MPF® and MPP, provide members with an alternative to Fannie Mae and Freddie Mac execution. The level of activity in the MPF® and MPP programs has been declining as several FHLBanks discontinued or scaled back participation in the programs. As of March 31, 2013, mortgage assets comprised 6.5% of System assets, versus 12.3% as of year-end 2004. The FHLBanks' mortgage assets are more susceptible to credit loss, and in particular, carry heightened operational complexity relative to the FHLBanks' core lending business. Credit risk performance of MPF® and MPP programs has been very good to date exceeding that of similar programs of Fannie Mae and Freddie Mac. This excellent track record reflects the high quality of mortgage assets purchased into the FHLBanks' MPF® and MPP programs.

#### Liquidity and Funding

FHLBank funding spreads have tightened considerably resulting in margin expansion as its liabilities re-priced quicker than its assets in a declining rate environment. The FHLBanks' GSE status has provided it with consistent and stable access to the debt market. The FHLBanks internal sources of liquidity are modest.

The Federal Housing Finance Agency, the regulator of the FHLBanks, requires each FHLBank to maintain sufficient liquidity, through short-term investments, in an amount at least equal to an FHLBank's anticipated cash outflows under two different scenarios. One scenario assumes that an FHLBank cannot access the capital markets for a period of 15 days during which it is assumed that members do not renew any maturing, prepaid or called advances. The second scenario assumes that an FHLBank cannot access the capital markets for a period of five days during which it is assumed that an FHLBank will automatically renew maturing and called advances

for all members, with certain exceptions for very large members, provided the member is well-rated. All FHLBanks met the liquidity requirements as of March 31, 2013.

Other

A significant underpinning of the BCA is the joint and several nature of the FHLBanks' consolidated obligations. The financial strength of individual FHLBanks is very sound, and the joint and several liability contributes to the overall strength of the FHLBank System by narrowing the ratings differences among the individual FHLBanks that could exist were ratings to exclude the joint and several feature. As a result, the ratings of the weakest FHLBanks are increased, and the ratings of the strongest are lowered.



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